

STATE OF MAINE  
PUBLIC UTILITIES COMMISSION

Docket No. 99-111

February 11, 2000

MAINE PUBLIC UTILITIES COMMISSION  
Standard Offer Bidding Procedure

ORDER DIRECTING CENTRAL  
MAINE POWER COMPANY TO  
CONTRACT FOR WHOLESALE  
POWER SUPPLY AND  
ESTABLISHING STANDARD  
OFFER PRICES

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WELCH, Chairman; NUGENT and DIAMOND, Commissioners

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## **I. SUMMARY**

In this Order, we direct Central Maine Power Company (CMP), pursuant to Chapter 301 § 8(B)(2) of our rules, to enter into a one-year wholesale power supply contract with a supplier it has chosen through an offer solicitation process. The wholesale power contract will provide the supply for CMP's medium and large non-residential standard offer classes. We conclude that CMP acted prudently in soliciting offers to provide wholesale power supply and in selecting the winning supplier. Additionally, we establish amended standard offer prices for the medium and large non-residential classes as proposed by CMP, based on its projected cost of supply.<sup>1</sup>

## **II. BACKGROUND**

The Restructuring Act requires that "when retail access begins, the Commission shall ensure that standard-offer service is available to all consumers of electricity." 35-A M.R.S.A. § 3212. The Commission promulgated Chapter 301 to establish the terms and conditions for standard offer service as well as the bid process for the Commission to use to select standard offer service providers, as required by 35-A M.R.S.A. § 3212(2).

Pursuant to Chapter 301, the Commission conducted a solicitation for bids to provide service to CMP's three classes of standard offer customers. In an Order dated October 25, 1999, the Commission rejected all the bids received for CMP's service territory and solicited a second round of proposals. By Order dated December 3, 1999, the Commission accepted a \$0.04089/kWh bid to provide standard offer service to the

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<sup>1</sup> Chairman Welch dissents to the standard offer prices established in Section III(B) of this Order. See attached Dissenting Opinion.

residential and small non-residential customers, but rejected all bids for providing standard offer service to the medium and large non-residential customer classes. The Commission administratively set the standard offer price for the two larger classes at \$0.04089/kWh. As a consequence of the bid rejection for the medium and large non-residential standard offer classes, we directed CMP, pursuant to Chapter 301 § 8(D), to provide standard offer service to these classes using power procured from the wholesale market. We announced that we would meet with CMP in the near future to discuss the process by which CMP should procure power supply and the nature of the power supply that CMP should obtain.

On December 8, 1999, the Commissioners met with representatives of CMP and the Public Advocate to discuss power supply options for meeting the standard offer load.<sup>2</sup> At that meeting, CMP stated its view that standard offer supply would most effectively be met by a full requirements contract rather than by CMP's purchasing needed power on the NEPOOL spot market or through development and management of a power supply portfolio. The Commissioners and the Public Advocate agreed with CMP's assessment that it should initially attempt to obtain a full requirements contract before exploring other options.

As a result, CMP requested proposals for a full requirements wholesale power supply. In mid-December 1999, CMP sent a term sheet to 15 potential suppliers that had expressed interest in participating in CMP's RFP. The RFP sought fixed price proposals to provide the full requirements wholesale supply to serve CMP's medium and large non-residential customer classes. In its RFP, CMP stated that it would also consider offers for a partial requirements supply based on a fixed percentage of CMP's standard offer obligation. CMP also stated that bidders could choose to submit an offer on only one of the two available standard offer classes.

CMP received seven proposals (in the form of "indicative bids") in response to its RFP. Five of these proposals offered either full or partial requirements supply, while the other two proposals were for fixed block amounts of power. Based upon CMP's evaluation of the proposals, one bid, which would have provided full requirements for standard offer service, yielded the lowest cost and risk profile in CMP's judgment. That proposal was consistent with CMP's then current estimates of market rates.

At a December 23 meeting with the Commissioners and Public Advocate, CMP presented summaries and prices of the terms proposed by the five bidders. At that meeting, CMP indicated that two potential bidders had asked for an extension to submit proposals after Christmas and that CMP proposed waiting until the next week to consider any additional proposals. If additional proposals were not forthcoming by the next week, or if such proposals were less advantageous than the current "preferred" bidder, CMP proposed going forward with exclusive negotiations with that bidder.

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<sup>2</sup> The Commission also met with representatives of Bangor Hydro-Electric Company at the same meeting to discuss power supply options for providing standard offer service in BHE's service territory.

When additional bids were not forthcoming in the next week, CMP began exclusive negotiations with the preferred bidder and informed the other bidders who had submitted proposals of that action.

By early January, CMP and the preferred bidder had worked out a draft of a proposed contract in which they agreed to all terms and conditions of service. The only issue not finalized by the contract was the price of the power. By January 6, CMP began to receive indications that the preferred bidder might be unwilling to commit to the indicative bid originally proposed. The bidder indicated that the capacity portion of its supply was uncertain and that finality could not be reached until the issue about the capacity price was resolved. The installed capacity (ICAP) forward prices in the bilateral market were rising sharply and, without cover for its ICAP needs, the preferred bidder indicated that it might modify its price proposal. By Monday, January 10, the situation had worsened. A large block of ICAP for the second quarter traded at \$4/kW/month and the bidder told CMP that it would not go forward based upon its original price. On Tuesday, January 11, the preferred bidder withdrew from negotiations because of the ICAP situation.

Despite the lack of an underlying supplier, CMP filed a petition on January 11 to amend the standard offer prices that the Commission administratively set for the medium and large classes. Based on its efforts to date to obtain a wholesale supply, CMP indicated that the prices should be significantly higher than those previously set by the Commission, and that the prices should be seasonally differentiated for both classes and time differentiated for the large class. Specifically, CMP proposed the following standard offer prices:

	<u>Non-Summer</u>	<u>Summer</u>
Commercial	\$.052219/kWh	\$.064500/kWh
Industrial On-Peak	\$.056780/kWh	\$.105826/kWh
Industrial Off-Peak	\$.034100/kWh	\$.036781/kWh

CMP stated that these prices matched its estimates of the cost of procuring supply. As such, adoption of the proposed prices would mitigate under-collections (and resulting deferrals) and allow competitors to market against real supply costs. The seasonal differentiation would also eliminate the price incentive to “game” the system by strategically switching in and out of the standard offer.

After the preferred bidder withdrew from negotiations, CMP contacted the original bidders in an attempt to procure a power supply to meet the medium and large standard offer load. By Friday, January 14, CMP had received and evaluated two new power supply proposals to satisfy the standard offer load. Both suppliers (and other suppliers who did not submit renewed proposals) expressed concerns over the current ICAP market and sought to avoid or to mitigate the associated price risks in their proposals. Accordingly, both proposals received by CMP projected an increase in forward energy market rates. Both proposals were extremely time sensitive, with prices that were firm only until the close of business on Tuesday, January 18, 2000.

CMP met with Commissioners late on Friday, January 14 to present the two proposals it had received. CMP expressed the view that one supplier proposal was superior to the other and offered prices in an acceptable range. Under the preferred supplier's proposal, energy prices are fixed pursuant to a schedule of prices and all NEPOOL products, except ICAP, are included, as are renewables sufficient to meet Maine's requirements. With respect to ICAP, the supplier would act as CMP's agent and CMP would take all price and volume risk. The Commissioners advised CMP to submit its recommendation as a written petition in this docket that asks the Commission to direct CMP to enter its recommended power supply contract.

CMP filed its petition on January 18, which recommended entering into a contract with the preferred supplier for several reasons. First, the preferred supplier contract would provide the best set of obtainable, forward market prices for medium and large standard offer service. In CMP's view, the Restructuring Act envisions a fixed price for standard offer service. When compared to the other bid or spot market pricing, the preferred supplier contract would provide the greatest degree of price predictability.

Second, CMP asserted that the prices provided in the preferred supplier contract do not appear unreasonable for the standard offer product being procured. In essence, CMP's RFP requested an option price on almost 1000 MW of load. The supplier has all the price risk, yet has absolutely no certainty of the volume to be served. The supplier must hedge against the risk of energy price changes, but receives no certainty that the cost of the hedge will be recovered because there is no certainty of load.

Third, the preferred supplier contract satisfies Maine's renewables requirement. CMP asserted that if it must procure energy from the NEPOOL spot market or manage a portfolio to serve the standard offer load, it is questionable whether the renewable requirements could be met. To date, CMP states there is no real market in NEPOOL for renewables. Moreover, resources that qualify as renewable make up less than 30% of the NEPOOL system. Thus, without a fixed contract that requires satisfaction of the renewable requirement, CMP believes it would have no means of meeting the requirement.

Last, CMP asserted that not committing to purchase the full expected ICAP requirement makes the most sense at this time. CMP stated that prices in this market appear artificially high today and that ICAP prices should come down as expected capacity additions come on line over the next six months. CMP also pointed out that it is uncertain how much load will be served on the medium and large standard offer. Thus, to purchase sufficient ICAP to meet the total 1000 MW of load at today's prices could expose customers to unnecessary costs.

The Commission received two letters from parties who were served with CMP's petition. The Public Advocate stated general support for CMP's petition and recommended that the Commission direct CMP to enter into the power supply contract with the preferred supplier. The IEPM asked the Commission to set the standard offer

price for CMP's medium and large non-residential customer classes based on the actual costs of providing that service, including the Commission's best estimate of the cost of ICAP over the next year.

On January 21, 2000, CMP filed a revised petition to amend the standard offer prices for the medium and large classes. The proposed prices in its January 11<sup>th</sup> filing were based on CMP's estimate of the cost of supply. The January 21<sup>st</sup> filing revised the proposed prices based on the wholesale contract CMP negotiated with the preferred supplier. Specifically, CMP proposed the following prices:

	<u>Non-Summer</u>	<u>Summer</u>
Commercial	\$.055200/kWh	\$.068100/kWh
Industrial On-peak	\$.059250/kWh	\$.110410/kWh
Industrial Off-peak	\$.033783/kWh	\$.038823/kWh

CMP calculated these prices to reflect the actual energy prices in its wholesale contract and CMP's best current estimate of reasonable ICAP prices. CMP also computed and presented to the Commission standard offer prices using both a higher and a lower estimate of ICAP prices.<sup>3</sup>

### III. DISCUSSION

#### A. Standard Offer Supply

We find that CMP has acted prudently in the manner and process by which representatives of the Company sought to acquire wholesale power supply to serve the standard offer service for the medium and large non-residential customers. CMP has reasonably conducted a bid process that has resulted in a reasonable market price for a full requirements contract (other than ICAP) to serve standard offer load. We agree with CMP that prices in the ICAP market appear artificially high at the present time. We also concur with CMP that ICAP prices can be expected to come down over the next few months and that, as CMP argues, the load risk may be better defined in the future such that the ICAP requirements may be diminished. Accordingly, our finding of prudence includes CMP's decision not to acquire all the necessary ICAP for its standard offer load at this time. Because CMP has acted prudently and has obtained a wholesale supply at a reasonable cost, we direct CMP to enter a contract with the preferred supplier that is essentially in the form as provided in CMP's petition of January 18, 2000.<sup>4</sup>

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<sup>3</sup> The Commission deliberated the matter of CMP's wholesale power supply on January 18, 2000 and the standard offer prices on January 27, 2000.

<sup>4</sup> CMP sought and received a protective order that treats the proposed contract as confidential business information. The supplier asserts that the contract, including the prices, constitute confidential business information. Other bidders made the same

The primary issue raised by CMP's proposed contract and course of action is whether it would be preferable to procure a wholesale supply for standard offer service on the NEPOOL spot market or through the development and management of a power supply portfolio.

By CMP's estimates in the confidential backup to its petition,<sup>5</sup> CMP's analysis shows that it believes that its full requirements contract requires a four to five mil/kWh risk premium above CMP's best forecast of market prices over the next year. This premium is similar for both the medium and large classes. We agree with CMP that, everything else being equal, a market portfolio strategy should result in lower power supply costs because of the removal of the risk premium. The question then becomes whether the premium paid to eliminate the forecast risk is reasonable. We perceive that question to be a very close call. Although the risk premium for wholesale cost certainty may be significant, the immaturity and recent history of the NEPOOL energy markets and the characteristics of the medium and large customer classes cause us to accept the premium. Thus, we decide to accept CMP's recommendation that it enter into the full requirements contract with the preferred supplier.

Three factors persuade us to accept CMP's recommendation that it enter the proposed full requirements contract. First, there is a great amount of uncertainty in the wholesale markets. As a result, there is a reasonable possibility that a spot market or portfolio choice will result in higher prices than would be achieved by accepting the full requirements contract.

Second, the Legislature decided to deregulate generation services in order to avoid creating new uneconomic or stranded costs. The uneconomic costs in rates today entirely result from generation-related costs. CMP's proposed full requirements contract achieves the goal of minimizing the potential for future uneconomic or stranded costs as compared to a portfolio or spot market strategy.

Third, if the price for standard offer service that reflects CMP's wholesale power contract is in fact too high under future market conditions, customers in the medium and large customer classes should be able to obtain lower-priced alternatives to standard offer service from the market. Because the load risk is accepted by the wholesale supplier, CMP will not have additional costs when customers leave standard offer service.

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assertion about their prices. Because the supplier will be seeking installed capacity (ICAP) in the market for CMP, CMP and the supplier ask that the name of the supplier remain confidential until the necessary ICAP is purchased. We have granted their request.

<sup>5</sup> CMP's market price forecast information and its analysis of bids are also subject to a protective order.

For these reasons, the goals of restructuring and the interests of medium and large standard offer customers, as well as utility ratepayers in general, are best served by CMP entering into the full requirements contract. Accordingly, we direct CMP to enter into the full requirements contract that is described in its January 18 petition and find that CMP's actions in procuring and entering into the full requirements contract are prudent (including CMP's decision to exclude ICAP from the contract).

B. Standard Offer Prices

We adopt the standard offer prices for the medium and large non-residential classes proposed by CMP in its January 21st filing. These prices are:

	<u>Non-Summer</u>	<u>Summer</u>
Commercial	\$.055200/kWh	\$.068100/kWh
Industrial On-peak	\$.059250/kWh	\$.110410/kWh
Industrial Off-peak	\$.033783/kWh	\$.038823/kWh

We agree with CMP and other commenters that the standard offer prices should closely reflect the underlying cost of supply. This will minimize the potential for significant under-or over-collections that would have to be addressed through future ratemaking. Additionally, it is critical that suppliers not have to compete against standard offer prices that are artificially low because they do not reflect the actual cost of service. We also agree with CMP that seasonally differentiated prices should significantly reduce the potential for "gaming" the standard offer to the detriment of other customers.

The prices proposed in its January 21st filing reflect CMP's actual contract rates for energy (and associated ancillary services) and its best estimate of the future cost of ICAP. We have reviewed CMP's estimates of future ICAP prices and have no basis to regard them as unreasonable or to believe that we can make more accurate estimates. We, thus, adopt the standard offer prices proposed by CMP. We will, however, closely monitor CMP's actual supply costs as compared to the standard offer prices and will consider modifying the prices if they do not reasonably reflect supply costs.<sup>6</sup>

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<sup>6</sup> While we previously expressed a disinclination to lower standard offer prices during the course of the year, that disinclination may disappear if CMP's actual costs prove to be materially below those on which we base these standard offer prices, and competitive suppliers nonetheless choose not to enter the Maine market. As to the alternative proposed in the dissent of setting the standard offer prices modestly below the levels warranted by CMP's most recent cost estimates and raising them if dictated by market conditions, that approach might actually harm its intended beneficiaries. A below market standard offer price could keep competitive suppliers out of the market, leaving customers with no alternatives if we indeed had to order a mid-year increase in the standard offer price to avoid new stranded costs.

Dated at Augusta, Maine, this 11th day of February, 1999.

BY ORDER OF THE COMMISSION

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Dennis L. Keschl  
Administrative Director

COMMISSIONERS VOTING FOR: Nugent  
Diamond  
Welch: Concurring in part and dissenting in part.  
See attached dissenting opinion.



**DISSENTING OPINION OF  
CHAIRMAN WELCH**

I concur entirely in the decision and reasoning of my colleagues in this matter with one exception. I agree that the somewhat lower standard offer prices submitted by CMP on January 14, which I would adopt, increase the risk that the costs that CMP will pay for the supply it needs to serve these standard offer classes will exceed the revenues it receives. Nevertheless, I prefer to avoid magnifying the rate increases that will be suffered by customers in these classes who remain on the standard offer, whether due to their own inattention, or, perhaps as likely, due to the absence of sufficient sellers in the market to allow them to buy at a lower price. If we set prices at modestly lower levels now, we would still have the ability to raise prices if ICAP costs remain high; this provides an avenue to avoid building a new stranded cost burden for CMP's ratepayers. On the other hand, if ICAP costs fall, the higher standard offer prices we set today represent, for the customers who pay them, an unnecessary burden. For that reason, I dissent from the decision to set standard offer prices at the levels proposed in CMP's January 21 filing rather than the modestly lower levels proposed on January 14.

## NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.
2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within 30 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Civil Procedure, Rule 73, et seq.
3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.